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ST. CLOUD AREA QUARTERLY BUSINESS REPORT

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Executive Summary

The growth of the St. Cloud area economy should accelerate over the next several months according to the most recent projections of the **St. Cloud Index of Leading Economic Indicators** and the **St. Cloud Area Business Outlook Survey**. Both instruments are designed to forecast economic conditions in the St. Cloud area over the next four to six months. Recent increases in the leading indicators index helped push the November 1999 index to a record high. In recent months, the index has been boosted by the U.S. index of leading economic indicators, an increase in average weekly hours worked at area manufacturing establishments, and a surge in new residential electrical hookups. Eighty percent of area businesses participating in the Business Outlook Survey expect an increase in the level of business activity for their company over the next six months. This compares to only 5 percent who expect conditions to worsen. Forty-nine percent of surveyed businesses in the St. Cloud area expect to add employees over the next six months. Approximately two-thirds of survey respondents expect employee compensation to rise in the next half-year. While shortages of qualified workers continue to be a concern of many area employers, there does appear to be some moderation in the local labor shortage. Thirty-eight percent of businesses responding to the survey believe it will become more difficult to attract qualified workers over the next six months. This compares to a fifty percent response to the same survey item reported in the October 1999 **St. Cloud Area Quarterly Business Report**. Area firms consider the business environment in the St. Cloud area to be somewhat better than Minnesota overall. Eighty-four percent of firms who were asked to compare the business environment in the St. Cloud area to Minnesota overall responded "about the same" or "somewhat better." No firms responded "much worse" to this special question.

St. Cloud Index of Leading Economic Indicators

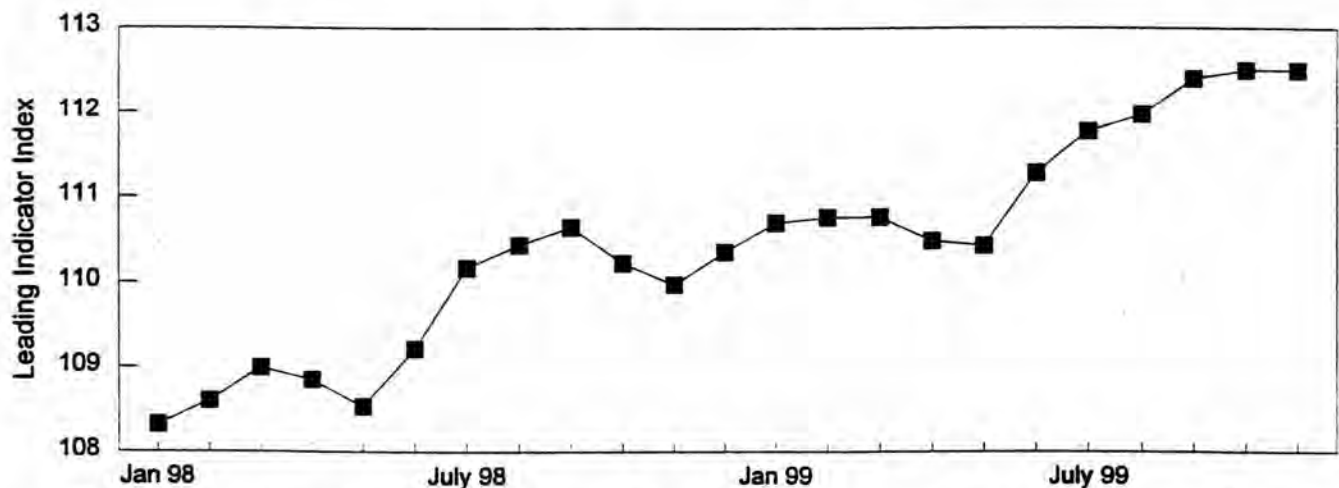
The November 1999 **St. Cloud Index of Leading Economic Indicators** predicts that local economic activity will expand into Spring 2000. The index is being lifted by the rising U.S. index of leading economic indicators, increases in the average St. Cloud manufacturing workweek, and new residential electrical hookups. A relatively flat trend in new St. Cloud Area business start-ups has had a neutral effect on the index of leading indicators. The **St. Cloud Index of Leading Economic Indicators** reached a record level in November 1999. This marked the sixth consecutive monthly increase in the index. As a rule of thumb, three consecutive

positive changes suggest an expanding economy, while three consecutive decreases suggest a contracting economy and/or a slowing of economic growth.

St. Cloud employment growth sharply accelerated in the latter half of 1999. Nonfarm employment grew by 2.4% between November 1998 and November 1999. Conversely, in the year ending in April 1999, nonfarm employment actually declined by 0.1%. This turn-around reversed a trend of the latter 1990s when employment growth in the St. Cloud area trailed the state and nation. For example, U.S. and Minnesota nonfarm employment grew at 2.1% and 1.8% rates, respectively, for the year ending November 1999. St. Cloud is currently faring better than other Minnesota metropolitan areas in terms of year-over-year employment growth. The respective November 1998 through November 1999 employment growth rates for the Twin Cities, Rochester, and Duluth areas were 2.2%, 2.2%, and 1.6%. These trends indicate that St. Cloud remains one of the brightest spots in the Greater Minnesota economy.

Four to Six Month Leading Indicator Index

St. Cloud, MN (1994=100) Nov 1999



Source: SCSU Center for Economic Education, Social Science Research Inst., R.MacDonald, M.Partridge

There are several possible reasons for St. Cloud's renewed economic vigor in late 1999. A sharp increase in new residential electrical hookups suggests a recent influx of new residents. New residents add to the labor pool and help alleviate the local labor shortage. The in-migration of new residents is an encouraging sign for the St. Cloud area. It suggests that the quality of life in the St. Cloud area is superior to other locations. Continued improvements in the quality of life will help relieve pressures associated with the local labor shortage.

Another reason for vigorous St. Cloud Area job growth appears to be that local employers are adjusting business practices in response to the tight labor market environment of the late 1990s and early 2000s. Recent Business Outlook Surveys have found that area businesses continue to invest in new capital, including information technology. This investment helps mitigate the need for new hires. Anecdotal evidence also suggests that local businesses are altering employment practices by hiring individuals (such as welfare recipients) who would not have been seriously considered in the past. Respondents to the Business Outlook Survey indicated that they "have had to go out of state to hire qualified people" and noted that they are "attracting good people (who are) migrating outstate from the Twin Cities area." This marks a dramatic reversal from the norm. The survey results continue to suggest that a key factor in retaining and attracting workers is a compensation package that reflects tight labor-market conditions. Over two-thirds of surveyed firms expect to increase worker compensation over the next six months.

Often, an indicator of a future economic downturn is unbalanced sectoral growth. When fewer growing sectors are being offset by an increasing number of declining sectors, economic activity is likely to slow. The St. Cloud economy is extraordinary in the degree to which economic growth is balanced across all sectors. Perhaps the only plausible near-term threats to local economic growth are sharp increases in interest rates by the Federal Reserve and an abrupt decline in the stock market, and even those threats are not likely.

St. Cloud's high growth sectors include construction, general merchandise retail (mostly large retail stores), and state government education (primarily SCSU and St. Cloud Technical College), where employment in the year ending November 1999 grew by 6.9%, 8.6%, and 15.0%, respectively. Expansion in construction continues a trend of the last few years. In fact, building permit data suggest that local residential construction levels in early 2000 will slightly exceed the heady levels of early 1999. Overall, there are few signs that recent interest rate hikes have slowed the local construction boom. It is also noteworthy that St. Cloud manufacturers appear to be prospering despite a competitive global environment. In the year ending November 1999, St. Cloud area manufacturing employment increased by 1.6%. This compares favorably to a 1.6% national decline as well as no change in Minnesota manufacturing employment over the same time period. Since manufactured products can be produced nearly anywhere in the world, the relative success of local manufacturing is consistent with a favorable local business environment. A special question on the Business Outlook Survey asked area firms to compare the business environment (eg. rents, labor quality/availability, regulations & taxes, amenities, etc.) in St. Cloud to Minnesota overall. Eighty-four percent of responding firms ranked St. Cloud's business environment as "about the same" or "somewhat better" than Minnesota overall.

In terms of employment growth, the only declining St. Cloud area sectors over the last year were: other retail (net of large department stores), (non-government) educational services, federal government, and local government education. Most interesting is the decline in other retail employment. This suggests that smaller retailers are having a difficult time in attracting and retaining employees, most likely because they are unable or unwilling to pay market wages.

Other indicators also suggest a healthy local economy. New unemployment insurance claims in the St. Cloud area are at an historically low level. The November 1999 St. Cloud metropolitan

area unemployment rate was extremely low at 2.1%. This is a slight decline from 2.3% one year earlier. Help wanted ad lineage in the *St. Cloud Times* was about 4% higher in early Fall 1999 than in the corresponding period in 1998. This is noteworthy since help wanted lineage was at very high levels in Fall 1998. Average hourly manufacturing wages in the September-November period were about 3.8% above the level during same period in 1998. This marks a rapid acceleration from the 0.8% annual growth rate in manufacturing wages during the preceding three months (June-August). Although hourly wage growth is influenced by many factors, such an acceleration is consistent with the effects of tight labor market conditions. Finally, respondents to the **St. Cloud Area Business Outlook Survey** are extremely optimistic regarding future business activity. Overall, while certain sectors are facing adjustment problems related to a long-term labor shortage, the St. Cloud economy is very strong.

St. Cloud Area Business Outlook Survey

The **St. Cloud Area Business Outlook Survey** is a survey of current business conditions and area firms' future outlook. It is administered quarterly with the cooperation of the St. Cloud Area Chamber of Commerce. Survey results reported in Tables 1 and 2 reflect the responses of fifty-five area business firms who returned the recent mailing of the Business Outlook Survey. Participating firms are representative of the collection of diverse business interests in the St. Cloud area. They include retail, manufacturing, construction, financial, and government enterprises of sizes ranging from small to large. Survey responses are strictly confidential. Written and oral comments have not been attributed to individual firms.

Area businesses remain extremely optimistic about future business conditions. The December 1999 diffusion index for future business activity is 74.5. This is sharply higher than its level in September 1999 (39.2) and December 1998 (46.9). The diffusion index is measured as the percentage of respondents expecting an increase minus the percentage expecting a decrease. Thus a widening of this number is a very encouraging sign. Eighty percent of area firms expect the level of business activity for their company to increase over the next six months compared to 5.5 percent expecting a decrease in activity. The December 1999 diffusion index for *current* business activity is basically unchanged from its level in September. It should be noted that survey results have not been seasonally adjusted. Several firms note that they experience seasonal variation in business activity. Comments from area firms include, "business activity increases are creating problems for staff--difficult to keep up." Also, "I used to be able to take on special projects from Thanksgiving to mid-January due to lower business activity levels. This has *not* been the case the last two years."

Area firms expect to meet increased future output demand by hiring additional workers and acquiring more capital. Some firms expect the length of the workweek to expand over the next six months. Only twenty-two percent of surveyed firms expanded company payroll employment over the past three months. This is much lower than the 45% increase in new hires one year ago. Forty-nine percent of survey respondents expect to hire more workers over the next six months. This compares favorably to firm forecasts of new hires in the September survey. Some area firms are starting to see a moderation of the local labor shortage. Only thirty-eight percent of surveyed firms indicate that they expect increased difficulty attracting qualified workers six months from now. While this indicates a continuing struggle with the availability of workers,

this is the lowest figure that has been reported since the **St. Cloud Area Business Outlook Survey** was initiated in December 1998. One area firm notes that "to date we have had very little difficulty finding good people." But another firm remarks "still the biggest problem is attracting good employees!"

Survey responses indicate that the St. Cloud area is in a mature phase of its economic cycle. A healthy number of firms are planning to increase capital purchases over the next six months and almost two-thirds of surveyed firms plan to increase worker compensation over the same time period. The **St. Cloud Index of Leading Economic Indicators** suggests that strong growth in residential electrical hookups is demonstrative of new workers moving to St. Cloud. Firms are also relatively confident that they can increase prices over the next several months. Productivity increases from capital improvements as well as the high quality of the St. Cloud area work force continues to furnish a healthy competitive balance for area companies. Generally, respondents' ability to pass on price increases is little changed from the September survey, but is much improved from one year ago. One firm comments that "we are looking at a price increase probably in April to June of 10%."

Despite the upbeat tone, some respondents noted some concerns. For example, a firm that receives much of its revenue from the government notes that "our ability to increase revenue parallel to competitive staff wages needed is grossly underfunded. Also, recent increases in health benefit costs across our industry have compounded the problem to recruit and retain staff." Another firm said that "People in the St. Cloud area are very conservative yet our prices should be higher based on other areas. We see our profits decreasing because of increased labor [costs] and regulations." Finally, an area firm notes that "our business takes a very specific, focused, goal oriented approach. Today's business environment is so cluttered that if you don't take such an approach, it is easy to become distracted and confused. Distractions and confusion today can cost a business dearly in wasted financial and human resources."

The March 1999 **St. Cloud Area Business Outlook Survey** asked companies about their concerns regarding "Y2K" effects. Most area companies were making (or had already made) Y2K preparations at that time. They had "no change" in their attitudes about these effects either at that time or in the future. The April 1999 **St. Cloud Area Quarterly Business Report** noted that "In general, area firms appear to be quite confident that any adverse 'Y2K' effects will be temporary and minor" and "Survey participants seem to agree that life will go on after January 1, 2000." At the time this sanguine view seemed somewhat surprising because some analysts were suggesting widespread disruptions. In retrospect, area firms' confidence about Y2K compliance appears to have been justified.

A marked change in area firms' views of national economic conditions was observed in the most recent survey. Twenty-nine percent of surveyed firms expect national business activity to improve over the next six months. Only 7 percent of firms expect worsening future national business conditions. Compared to September's diffusion index of 1.8, the 21.8 diffusion index on expected national business conditions indicates a healthy view of national economic trends. This optimism is surprising given that many analysts argue that the national economy cannot sustainably grow faster than its current rapid pace.

This quarter's special question asked surveyed firms to compare the business environment (for example, rents, labor quality/availability, regulations & taxes, amenities, etc.) in St. Cloud to Minnesota overall. No firms indicated that the St. Cloud business environment was "much worse" than Minnesota overall. In addition, 9.1% of surveyed firms indicated it was "somewhat worse" and 3.6% thought it was "much better." Almost 42% of firms responded "about the same." An equal percentage responded "somewhat better." One firm stated that St. Cloud is a "fast growing community--attracting good people. People migrating outstate from Twin City area." Another firm noted that "there is a very high quality work force in the St. Cloud area." One survey respondent remarked "I feel the labor shortage is a bigger problem in St. Cloud, otherwise (we are) the same as most of the state." Finally, one firm suggested that this "should have been a two part question due to the *extreme* differences between rural and urban areas. Without question, St. Cloud is *way* better than small rural communities--we are behind progressive metro areas." It appears that the St. Cloud area is not only a nice place to live, it is also a nice place to do business.

The end of February 2000 will mark the record for the longest economic expansion in U.S. history (nine years). Even more remarkable is that St. Cloud has not experienced an economic downturn since the early 1980s. The ultimate duration of this exceptional period of local economic prosperity will be largely determined by (1) how long the U.S. economy continues to expand and (2) whether St. Cloud can adapt to the so-called "new economy." The new economy is the notion that the U.S. economy can rapidly grow as a result of new information technologies (including the internet) as well as fresh opportunities that have arisen from the global economy. St. Cloud State University's Economic Education Winter Institute will explore the new economy and its impact on regional economic activity in more detail on February 24-25. Readers of the **St. Cloud Area Quarterly Business Report** will be receiving details of the 38th Annual Winter Institute in the near future.

Look for the next **St. Cloud Area Business Outlook Survey** in March and the accompanying **St. Cloud Area Quarterly Business Report** (including the **St. Cloud Index of Leading Economic Indicators**) in April 2000.

TABLE 1--CURRENT BUSINESS CONDITIONS*

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary December 1999	December 1999 vs. Three Months Ago				September 1999 Diffusion Index ³
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index ³	
What is your evaluation of:					
level of business activity for your company	25.4	27.3	47.3	21.9	21.1
number of employees on your company's payroll	20.0	58.2	21.8	1.8	32.8
length of the workweek for your employees	10.9	74.5	14.5	3.6	12.7
capital expenditures (equipment, machinery, structures, etc.) by your company	9.1	63.6	27.3	18.2	21.8
employee compensation (wages and benefits) by your company	0	50.9	49.1	49.1	52.7
prices received for your company's products	10.9	58.2	29.1	18.2	20.0
national business activity	12.7	52.7	23.6	10.9	23.6
your company's difficulty attracting qualified workers	7.3	47.3	45.4	38.1	50.9
SPECIAL QUESTION: Compared to Minnesota overall, do you believe the business environment in the St. Cloud area (eg. rents, labor quality/availability, regulations & taxes, amenities, etc.) is:	Much Worse 0%	Somewhat Worse 9.1%	About the Same 41.8%	Somewhat Better 41.8%	Much Better 3.6%
Notes: (1) reported numbers are percentages of businesses surveyed. (2) rows may not sum to 100 because of "not applicable" and omitted responses. (3) diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion.					

* Source: SCSU Center for Economic Education, Social Science Research Institute,
and Department of Economics

TABLE 2--FUTURE BUSINESS CONDITIONS*

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary December 1999	Six Months from Now vs. December 1999				September 1999 Diffusion Index ³
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index ³	
What is your evaluation of:					
level of business activity for your company	5.5	12.7	80.0	74.5	39.2
number of employees on your company's payroll	5.5	45.5	49.1	43.6	35.8
length of the workweek for your employees	3.6	76.4	20.0	16.4	5.4
capital expenditures (equipment, machinery, structures, etc.) by your company	5.5	58.2	36.4	30.9	28.6
employee compensation (wages and benefits) by your company	0	32.7	67.3	67.3	66.1
prices received for your company's products	5.5	54.5	36.4	30.9	35.7
national business activity	7.3	54.5	29.1	21.8	1.8
your company's difficulty attracting qualified workers	3.6	54.5	38.2	34.6	46.4
Notes: (1) reported numbers are percentages of businesses surveyed. (2) rows may not sum to 100 because of "not applicable" and omitted responses. (3) diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion.					

* Source: SCSU Center for Economic Education, Social Science Research Institute,
and Department of Economics